

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF BEULAH SEWER COMPANY,)
INC., FOR AN ADJUSTMENT OF RATES)
PURSUANT TO THE ALTERNATIVE RATE FILING) CASE NO. 9544
PROCEDURE FOR SMALL UTILITIES)

O R D E R

IT IS ORDERED that:

1. The Staff Audit Report for Beulah Sewer Company, Inc., ("Beulah") attached hereto as Appendix A shall be included as a part of the record in this proceeding.

2. Beulah shall have until the close of business within 2 weeks of the date of this Order to file written comments concerning the contents of Appendix A.

Done at Frankfort, Kentucky, this 18th day of June, 1986.

PUBLIC SERVICE COMMISSION

Richard D. Hemmelf
Chairman

[Signature]
Vice Chairman

[Signature]
Commissioner

ATTEST:

Secretary

APPENDIX A

REPORT ON LIMITED AUDIT OF BEULAH SEWER COMPANY, INC.

PREFACE

On March 31, 1986, Beulah Sewer Company, Inc. ("Beulah") filed, pursuant to 807 KAR 5:076 (Alternative Rate Filing), an application seeking an increase in rates. The proposed rates would generate \$20,460 annually in additional revenues.

In order to expedite the processing of the case and substantially reduce the need for written data requests, the Commission staff chose to perform an audit, limited in scope, on the operations of Beulah. The audit was conducted by Ms. Angela Schweickart of the Division of Rates and Tariffs on April 30 and May 28, 1986, at the offices of Beulah and Richardson, Pennington and Skinner, CPAs, in Louisville, Kentucky.

SCOPE

The scope of this audit was limited to ascertaining whether the operating expenses for the test year ended September 30, 1985, were accounted for in accordance with the Uniform System of Accounts for Sewer Utilities ("USoA").

FINDINGS

Mr. Jack Futch, the President of Beulah, owns three businesses, Beulah, J&F Construction ("J&F") and Futch Air Conditioning and Heating ("Futch"). The sewer utility is operated out of the Futch office.

The sewer treatment plant is owned jointly by J&F and Beulah. Citizens Fidelity Mortgage Company holds a mortgage on the entire plant. J&F financed the plant with a note which currently has a balance of \$221,860. The original amount of the loan could not be determined during the limited audit. In 1979, J&F transferred the plant to Beulah for \$50,000. Beulah was supposed to assume \$50,000 of the note payable in payment of the plant. However, Beulah has not made any interest or principal payments on the note or included any accrued interest expense in the income statement or the balance sheet.

Per the annual report, Beulah carries on its balance sheet the total plant and the total loan amount payable of \$221,860. According to the USoA, the correct entry for the transfer of the plant to Beulah from J&F would have been to debit plant for the original cost, credit accumulated depreciation, credit notes payable for \$50,000 and credit contributions in aid-of-construction for the balancing amount. It is recommended that Beulah make the necessary correcting entries to conform with the USoA.

Pursuant to 807 KAR 5:006, Section 3, Beulah is required to file annual reports on a calendar basis. During the limited audit, it was disclosed that Beulah had been filing September 30 fiscal year-end annual reports. Since Beulah filed its application based upon the 1985 annual report, the September 30, 1985, test year has been used for the basis of the limited audit.

Beulah maintains its books on a cash basis during the year and makes year-end adjustments to change to the accrual basis. It became apparent during the limited audit that several unpaid expenses from prior years, which were never recorded, were expensed to the test year in the year-end adjustments. These expenses for prior years, when discovered, should be recorded as prior-period adjustments to retained earnings and not expensed in the year they are found. It is recommended that at the year end Beulah carefully examine all unpaid bills on hand and all the cash disbursements for the year in order to charge each expense to the correct period. Adjustments have been made in the following sections of this report to exclude the out-of-period expenses charged to the test year.

Beulah has neither been audited nor requested any increases prior to the present application. Following is a discussion of the recommended adjustments to the test year operating expenses:

Repairs and Maintenance Expense

Beulah reported for the test-year repairs and maintenance expense of \$8,764. During the test year, a \$755 bill from Louisville Gas and Electric Company ("LG&E") was incorrectly charged to this account. This expense has been reclassified to the utilities expense.

Beulah charged \$2,561 to the repairs and maintenance expense due to having the comminutor repaired. Beulah recorded an incorrect amount, as the actual invoice amount was \$2,732. Since this repair will benefit more than one period it should be capitalized

and depreciated over three years. Therefore, this expense has been excluded from the repairs and maintenance expense.

Beulah included in the test-year repairs and maintenance expense \$1,000 owed to J&F for paying a prior-year expense. This prior-year expense had not been recorded in the year it was incurred. Since the \$1,000 expense should be recorded as a prior-period adjustment and not included as an expense for the test year, it has been excluded from the repairs and maintenance expense for the test year.

Due to the reclassification and capitalization of the aforementioned items, the repairs and maintenance expense has been reduced to \$4,448.

Utilities Expense

The utilities expense reported by Beulah for the test year was \$10,631. This expense included the September 1984 LG&E bill that was not paid until October 1984. In addition, the October 1984 LG&E bill was incorrectly charged to the repairs and maintenance expense. In order to determine the actual test-year utilities expense, the September 1984 LG&E bill of \$744 has been excluded since it applied to electric expense incurred prior to the test period, while including the October 1984 LG&E bill of \$755. These adjustments result in a net effect of an \$11 decrease in the utilities expense. This adjusted utilities expense of \$10,642 included \$432 of late charges.

Insurance Expense

Beulah reported insurance expense for the test year of \$3,694. However, a review of this account disclosed that the

actual test-year insurance expense was \$1,345. The additional \$2,349 insurance expense is a past-due account which had not been recorded in prior years and was expensed during the test year. Since this amount should have been expensed during previous years, a prior-period adjustment should have been made adjusting retained earnings instead of expensing the amount during the test year. Therefore, the insurance expense has been reduced by \$2,349 to reflect actual test-year expense of \$1,345.

Taxes and Licenses

Beulah reported taxes and licenses expense for the test year of \$1,454. This amount included \$672 of property taxes associated with prior years. As stated previously, a prior-period adjustment should have been made instead of expensing the prior years property tax in the test year. Therefore, the correct test-year amount for taxes and licenses is \$782.

Interest Expense

As of October 1, 1984, Beulah had a past-due account with the Butler Construction Company ("Butler") for \$3,460. During the test year Butler sent Beulah a bill for interest expense for the period of October 1983 through August 1985 totaling \$1,656. Beulah expensed the total amount during the test year. A prior-period adjustment of \$780 should have been made to record the interest expense for October 1983 through September 1984. The actual interest expense for the test year is \$876.

As of the date of this audit, Beulah is not certain whether Butler is still in business since it has not received any bill from Butler or had any communication with a representative of

Butler since August 1985, and, therefore, Beulah assumes that Butler has been dissolved. The debt to Butler should be carried on Beulah's books until it is more certain that Beulah has been dissolved and then the liability should be written off Beulah's books.

Depreciation Expense

During the test year, Beulah had the collector gear box repaired at a cost of \$559. Beulah overlooked this unpaid expense and thus did not record it during the test year. Since this item will benefit more than one year it should be capitalized and depreciated over a 3-year period. The depreciation expense on this item will be \$186.

Beulah expensed a \$2,732 repair to the comminutor during the test year. As mentioned previously under the Repairs and Maintenance Expense Section, the staff is of the opinion that this repair should be capitalized and depreciated over a 3-year period. The additional depreciation expense on this repair will be \$911.

Beulah reported test-year depreciation expense on the total plant of \$9,627. Therefore, due to both of the aforementioned items, the depreciation expense has been increased to \$10,724. Because of the limited scope of this audit, the staff has not determined the reliability of Beulah's plant-in-service; therefore, the staff has made no attempt to verify Beulah's depreciation expense.

SUMMARY

The following is a summary of the effect of these adjustments on Beulah's test-year operating statement:

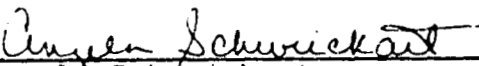
<u>Account</u>	<u>Test Year Reported</u>	<u>Staff Adjustments</u>	<u>Test Year Adjusted</u>
<u>Operating Revenues</u>	\$ 15,545	\$ -0-	\$ 15,545
<u>Operating Expenses:</u>			
Utilities Expense	10,631	11	10,642
Chemical Expense	288		288
Repairs & Maint. Exp.	8,764	<4,316>	4,448
Insurance Expense	3,694	<2,349>	1,345
Legal & Accounting	1,021		1,021
Office Supplies	22		22
Depreciation Expense	9,627	1,097	10,724
Taxes and Licenses	1,454	<672>	782
Total Operating Expenses	\$ 35,501	\$<6,229>	\$ 29,272
<u>Other Deductions:</u>			
Interest Expense	\$ 1,656	\$ <780>	\$ 876
NET INCOME	<u>\$<21,612></u>	<u>\$<7,009></u>	<u>\$<14,603></u>

A review of the accounting system revealed that Beulah has not maintained its books in accordance with the USoA. Due to the limited scope of this audit, the staff has not reclassified the expenses per Beulah's books into the proper accounts per the USoA. Beulah should adopt the USoA and adhere to its guidelines for accounting treatment of revenues and expenditures.

The staff has not determined the validity of the amount of gross operating revenues. The aforementioned items which were capitalized and depreciated should be reclassified on Beulah's

books. In addition, the accounting methods and entries recommended in this report should be followed.

Respectfully Submitted,


Angela Schweickart
Public Utilities Financial Analyst
Senior
Public Service Commission
Division of Rates and Tariffs
Revenue Requirements Section